BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----In the Matter of----)) PUBLIC UTILITIES COMMISSION)) Instituting an Investigation to) Reexamine the Existing Decoupling) Mechanisms for Hawaiian Electric) Company, Inc., Hawaii Electric) Light Company, Inc., and Maui) Electric Company, Limited.))	DOCKET NO. 2013-0141

DECISION AND ORDER NO. 31908

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PUBLIC UTILITIES COMMISSION

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DECISION AND ORDER

In this Decision and Order ("Order"), the Commission orders the HECO Companies[1] to make certain modifications to their decoupling mechanisms, and to include these modifications in their upcoming decoupling filings due on March 31, 2014. In addition, the commission is deferring certain issues for consideration in the second phase of this proceeding, as further discussed below.

[1]The "HECO Companies" are Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited("MECO").

I.

Background

By Order No. 31289, filed in this docket on May 31, 2013, the commission initiated this investigation to examine whether the existing decoupling mechanisms, as approved for the HECO Companies by the commission in its "Decision and Order" in Docket No. 2008-0274 (the "Decoupling Docket"),[2] effectively serve their intended purposes, are fair to the HECO Companies and the HECO Companies' ratepayers, and are in the public interest.[3]

The commission has described decoupling as follows:

> Generally, decoupling is a regulatory tool designed to separate a utility's revenue from changes in energy sales. Decoupling, as asserted by its proponents, has the benefits of encouraging the substitution of renewable resources, distributed generation and energy efficiency for the utility's fossil fuels production (by reducing a utility's disincentive to promote these types of resources and programs), while simultaneously protecting a utility's financial health from erosion as these types of programs go into effect.[4]

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[2]"Final Decision and Order and Dissenting Opinion of Leslie H. Kondo, Commissioner," filed on August 31, 2010, in Docket No. 2008-0274 ("Decoupling Order").

[3]Order No. 31289, "Initiating Investigation," at 1.

[4]"Order Initiating Investigation," filed on October 24, 2008, in Docket No. 2008-0274 ("Opening Order"), at 2-3.

Following a detailed examination of decoupling in Docket No. 2008-0274, on August 31, 2010, the commission issued its Decoupling Order, which approved the decoupling proposal set forth in the Joint Final Statement of Position, as amended, filed by the HECO Companies and the Consumer Advocate. In general, the Order approves decoupling, and establishes a Revenue Balancing Account ("RBA") and a Revenue Adjustment Mechanism ("RAM") for each of the HECO Companies.

The RBA is a sales decoupling component, which is designed to break the link between the HECO Companies' sales and their total electric revenues by setting the "Target Revenues" to the most recent authorized revenues approved in each utility's most recent rate case. Thus, the RBA is the difference between each utility's Target Revenue and recorded adjusted revenue, including monthly interest applied to the simple average of the beginning and ending month balances in the RBA.

The Target Revenue excludes revenues for fuel and purchased power expenses that are recovered either in base rates or in a Power Purchase Adjustment Clause ("PPAC"), as well as all other revenues being separately tracked or recovered through any other surcharge or rate tracking mechanism. The previous calendar year-end balance in the RBA (and the RAM Revenue

Adjustment for the current calendar year discussed below) is recovered through a single per kilowatt-hour ("kWh") RBA rate adjustment for residential and non-residential customers, assessed over the twelve months from June 1st of the current calendar year to May 31st of the succeeding calendar year.

The RAM is designed to compensate the HECO Companies for increases in utility costs and infrastructure investment between rate cases through formula-driven estimates. The components of the HECO Companies' revenue requirements that are subject to annual update and escalation through the RAM include the revenue requirements associated with: (1) changes in designated labor and non-labor operations and maintenance ("O&M") and payroll tax expenses; (2) the return on incremental investment in designated rate base components; (3) updated depreciation and amortization expenses; and (4) changes in costs due to significant changes in tax laws or tax regulations. The RAM for a current calendar year, along with the previous calendar year-end balance in the RBA, is recovered through the per kWh RBA rate adjustment described in the preceding paragraph.

The commission approved a number of consumer protection features in the Decoupling Order, including an Earnings Sharing Revenue Credit Mechanism and Credit Mechanisms for Major and Baseline Capital Projects. The commission also added certain modifications and conditions to the RAM to address the concerns that the commission and some of the parties had with respect to the RAM.

The commission required a reduction in each of the HECO Companies' authorized rates of return ("ROR") to account for the reduced risk to the Companies from the implementation of decoupling. Under the Decoupling Order, decoupling could not actually be implemented until rates that reflected a reduced rate of return ("ROR") due to decoupling were approved by the commission in either an interim or final decision and order in the HECO Companies' pending rate cases.

The commission subsequently considered and approved adjusted RORs for each of the HECO Companies, and, therefore, allowed implementation of decoupling as follows: (1) Final Decision and Order, filed on December 29, 2010, in Docket No. 2008-0083 (HECO's 2009 test year rate case); (2) Decision and Order No. 30168, filed on February 8, 2012, in Docket No. 2009-0164 (HELCO's 2010 test year rate case); and (3) Decision and Order No. 30365, filed on May 2, 2012, in Docket No. 2009-0163 (MECO's 2010 test year rate case). Since the initial approval of decoupling HECO has submitted three annual decoupling tariff filings (2011, 2012, and 2013), HELCO has submitted two such filings (2012 and 2013),[5] and MECO has submitted one such filing (2013).[6]

In Order No. 31289, the commission initiated this investigation into the operation of the decoupling mechanisms and clarified the distinct purposes of the RBA and the RAM:

> Although both mechanisms are grouped administratively under the sales decoupling mechanism umbrella, each serves a different purpose. As noted in the Decision and Order in the Decoupling Docket, the primary purpose of the RBA is to de-link or "decouple" the HECO Companies' revenues from the amount of electricity or kWh sold to remove financial disincentives due to sales declines attributable to aggressive pursuit of Hawaii's clean energy mandates. The RAM, on the other hand, serves to compensate the HECO Companies for changes in utility costs and infrastructure investment between rate cases.[7]

By Order No. 31635, filed on October 28, 2013, in this docket, the commission identified the specific issues to be addressed, and divided those issues into Schedule A Specific Issues ("Schedule A issues"), which are to be addressed on an expedited basis, and Schedule B Specific Issues

[5]HELCO's RBA Rate Adjustment for 2012 was negative, and, therefore, resulted in a reduction to customer bills.

[6]MECO filed its RBA Rate Adjustment schedules and workpapers in 2012 for informational purposes only.

[7]Order No. 31289 at 10.

("Schedule B issues"), which are to be addressed under a more extended procedural schedule.

Pursuant to the procedural schedule established in this docket, the following parties filed initial statements of position on or before November 12, 2013 ("Initial SOP"): the Consumer Advocate (sometimes referred to as the "CA"), the HECO Companies, the County Of Hawaii ("COH" or "County"), Hawaii Solar Energy Association ("HSEA"), Blue Planet Foundation ("Blue Planet"), and Hawaii Renewable Energy Alliance ("HREA"). Each of these parties also filed final statements of position on December 20, 2013 ("Final SOP"), and reply statements of position on January 7, 2014 ("Reply SOP").

On January 27 and 28, 2014, the commission heard oral argument from all parties concerning the Schedule A issues. As set forth in a letter to the parties dated January 21, 2014, the oral argument was structured on an issue-by-issue basis, and all parties were afforded an opportunity to make a closing argument.

This Decision and Order addresses each of the four Schedule A issues.[8]

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[8]Issue No. 5 is subsumed within Issue Nos. 1-4. Issue No. 5, as set forth in Order No. 31635 is as follows: ''RATE BASE: What factors should be considered if potential changes to existing RBA and RAM provisions are required in response to Issue Nos. 1 - 3?"

II.

General Principles Governing Review

Throughout the Decoupling Order, the commission specifically noted its authority and intent to review and/or terminate the decoupling mechanism at any time if the public interest so requires. For example, in Ordering Paragraph No. 7 of the Decoupling Order, the commission found:

> The following conditions that were agreed upon in the Energy Agreement should be explicitly adopted and shall apply to the future review of decoupling:
>
> (i) The commission may review the decoupling mechanism at any time if it determines that the mechanism is not operating in the interests of the ratepayers.
>
> (ii) The HECO Companies or the Consumer Advocate may also file a request to review the impact of the decoupling mechanism.
>
> (iii) The commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action.[9]

Likewise, in discussing the adjustment to each utility's ROR, the commission found:

> With a lowered ROR, and the other ratepayer protections (i.e., Earnings Sharing Revenue Credits) discussed below, the decoupling mechanism should operate fairly to both the HECO Companies and their ratepayers.

[9]Decoupling Order at 131-132; see also 122, 128.

> In the event that any inappropriate recovery of costs results from decoupling, the commission has the authority to unilaterally discontinue the decoupling mechanism... .[10]

Moreover, in discussing the ratepayer protections in the decoupling mechanism as approved, the commission found:

> The ratepayer protections approved herein should ensure that the decoupling mechanism operates fairly to the HECO Companies and their ratepayers. In the event any inappropriate recovery of costs results from decoupling, the commission has the authority to unilaterally discontinue the decoupling mechanism.[11]

More generally, the rates and charges of regulated public utilities in Hawaii must be reasonable, and the commission has broad powers to investigate and examine the rates and practices of public utilities subject to its jurisdiction.[12]

III.

Issue No. 1 - What Is The Appropriate Rate Of Interest To Be Applied To Outstanding RBA Balances?

As set forth in Order No. 31635, Issue No. 1 is as follows:

1. APPROPRIATE INTEREST RATE FOR OUTSTANDING RBA BALANCE: Whether the current interest rate applied to the outstanding RBA balance is reasonable?

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[10]Decoupling Order at 44.

[11]Decoupling Order at 124.

[12]See, e.g., HRS §§296-6, 296-7, and 296-16.

a. What is the basis for the interest rate currently applied to outstanding RBA balances?

b. What is the appropriate rate of interest to fairly compensate the utility and customers for RBA balances? Does the interest rate need to be the same for positive and negative balances?

c. Do any statutory provisions apply to the determination of interest rates on RBA balances?

A.

The Current Interest Rate

Currently, the accrual of interest on RBA balances is at an annual rate of 6% - the same as that accrued on customer deposits and specified in the HECO Companies' tariffs - and is applied to the simple average of the beginning and ending monthly RBA balances.[13]

B.

The Parties' Positions With Respect To The Appropriate Interest Rate

Not surprisingly, the parties have expressed a variety of opinions with respect to this issue. The HECO Companies succinctly summarize their position as follows:

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[13]This is an annual simple interest rate (i.e., one-twelfth of this rate will accrue per month).

> The current interest rate of 6% per annum that is applied to the outstanding monthly RBA balance was based on the Consumer Advocate's recommendation that it be consistent with the interest rate applied to customers' deposits by the Companies as required in Rule No. 6 of their tariffs. If the interest rate is changed, then each Company's latest approved composite cost of capital ("CCOC"), i.e., authorized rate-of-return ("ROR"), including revenue taxes, effective at the time the RBA balance is being accumulated, would be a fair and reasonable proxy of an interest rate to be applied to the outstanding RBA balances, since the authorized ROR adequately compensates those who have provided funds for use by the Companies.[14]

According to the HECO Companies, the authorized ROR represents the "carrying cost of funds received from investors to finance the investments and operations that serve the company's customers" and that it "has been used for the calculation of interest for many of the Companies' surcharge calculations such as refunds or interim rate increases, residential demand-side management ('DSM') adjustments, commercial and industrial adjustments, integrated resource planning ("IRP") cost recovery adjustments, and solar saver adjustments."[15] The Companies further stated that they were not aware of any specific statutory provision that applied to interest rates to be accrued on RBA balances, although they

[14]HECO Companies Initial SOP at 6; HEOC Companies Final SOP at 7.

[15]HECO Companies Final SOP, Exhibit 1 at 2.

generally observe that they are "entitled" to a fair rate of return under HRS § 269-16(b)(3).[16]

The HECO Companies repeat these points in their Reply SOP. In addition, they argue that utilization of the short term debt rate for the RBA balances, as requested by some parties, is not appropriate because it would lead to "double counting":

> Short-term debt and its associated costs are included in the Companies' CCOC approved by the Commission and, therefore, a portion of the CCOC already reflects that lower marginal cost of debt financing. Since customers already benefit from that lower marginal cost of debt, using the short term debt rate as the interest rate to be applied to the outstanding RBA balances will result in a double-counting of that lower marginal cost of debt.[17]

The Companies further observe that working capital is included in the calculation of rate base, and that the CCOC is applied to the total rate base. Thus, they maintain that the RBA balance is similar to working capital because the Companies must ''wait'' to recover their revenue entitlement (or, conversely, ratepayers must wait for a return of over-collections) and, therefore, the CCOC should be applied to the RBA balance as well.[18]

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[16]HECO Companies Initial SOP at 33-34; HECO Companies Final SOP, Exhibit 1 at 5.

[17]HECO Companies Reply SOP at 11; <u>see also</u> HECO Companies Final SOP, Exhibit 1 at 3.

[18]HECO Companies Reply SOP at 11-12.

Finally, the HECO Companies state that utilizing short term debt would add "another layer of complexity to the process," as the commercial paper rates vary over time and are dependent on the term.[19] Accordingly, the Companies recommend that if a short term debt rate is to be used, it should be established annually "based on a 364-day short-term debt estimate from the Companies (based on an estimate from Hawaiian Electric's commercial paper dealer)."[20] The HECO Companies support symmetrical interest rates for both shortfalls and surpluses.

In contrast to the HECO Companies' position, the Consumer Advocate supports utilization of the HECO Companies short term cost of debt.[21] At the outset, the CA observes that the current six percent rate was a negotiated result, but that it is not based on any measurement of the actual marginal cost of capital that may be associated with the RBA balances.[22] The CA states that:

> the Consumer Advocate has not conducted any studies to estimate the utility's marginal, net of income tax, short term debt cost rate

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[19]HECO Companies Reply SOP at 13.

[20]HECO Companies Reply SOP at 13.

[21]CA Final SOP at 4.

[22]CA Initial SOP at 7-8; CA Final SOP at 6.

> that could be considered reasonable as an update to the six percent interest rate agreed upon in 2009, but would support the conduct of such studies. Implementing reasonable updates to or modifications of the RBA interest rate would appear to be reasonable, as the earlier reliance on the interest rate for customer deposits within the decoupling mechanism was not specified by Commission rule or order and, as will be further discussed below, is not subject to any statutory provisions.[23]

Like the HECO Companies, the CA stated that it is "not aware of any statutory provisions requiring any specific interest rate, range of interest rates, or the establishment of a relationship to a widely available benchmark, such as the LIBOR as it relates to the interest rates on RBA balances."[24]

In its Reply SOP, the Consumer Advocate noted that in its Final SOP, it had recommended that the RBA interest rate issue be moved to Schedule B and evaluated as part of a larger review of decoupling in this docket.[25] However, in response to the HECO Companies argument that if the interest is changed now, the new interest rate should be the ROR, the CA states that it does not support use of the ROR, and further asserts that "if the RBA rate is changed in Schedule A of this docket, the cost of short-term debt incurred by the utilities should be

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[23]CA Initial SOP at 9; see also CA Final SOP at 6.

[24]CA Final SOP at 12; see also CA Initial SOP at 10.

[25]CA Reply SOP at 5.

ordered as the more appropriate rate on an interim basis, pending further review in Schedule B."[26]

Further explaining its position opposing the use of the ROR, the CA notes that the ROR has been used for the calculation of many of the Companies' surcharges, but further observes that either a lower interest rate or a zero interest rate has been allowed by the commission for other regulatory deferral and recovery mechanisms, including (1) zero interest on the Energy Cost Adjustment Clause, the Purchased Power Adjustment Clause, and the Public Benefits fund Surcharge Adjustment; (2) a 1.75% interest charge (a short-term debt rate) in the Renewable Energy Infrastructure Cost Recovery Provision; and (3) 6% interest on the RBA.[27]

The CA also states that, in the current, historically-low interest rate environment, applying interest at the utilities' overall ROR would excessively compensate the utilities for marginal costs that may be incurred by the utility to finance new working capital investments arising from growth in the RBA balance. Utility ROR rates would substantially overstate the marginal interest rate investment earnings opportunity available to most ratepayers who are investors at

[26]CA Reply SOP at 6.

[27]CA Reply SOP at 6-7.

the margin, while also overstating the marginal cost of debt capital available to ratepayers who are generally credit worthy.[28]

In response to the "double counting" argument posited by the HECO Companies (that is, because short term debt is included in the CCOC, the CCOC, in part, already reflects the lower marginal cost of financing), the CA states:

> However, the Consumer Advocate's recommendation to consider applying the short term debt cost rate as an RBA carrying charge does not depend upon any "allocation of the various types of debt and equity" as posited in HECO's FSOP. Instead, this proposal would recognize that marginal financing for short term investments like the RBA balance could be funded with incremental short term debt at lower resulting cost to ratepayers.[29]

Finally, the CA observes that setting the RBA interest rate at the level of short term debt would be consistent with the carrying charge authorized for REI cost deferrals and surcharge recoveries, and consistent with the Federal Energy Regulatory Commission's ("FERC") approved methods for determination of the Allowance for Funds Used During Construction ("AFUDC") that is applicable to short-term utility investments in Construction Work In Progress ("CWIP").[30]

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[28]CA Reply SOP at 7.

[29]CA Reply SOP at 9.

[30]CA Reply SOP at 9-10.

With respect to the latter, the CA proposes that the method used by FERC to determine the short term interest rate in the AFUDC formula be used here, observing that "[a]ctual short-term debt costs rates are verifiable within the limited time available for review of decoupling filings each year...."[31] Moreover, the CA rejects the proposition that if a short term interest rate is applied to RBA balances, the recovery should start on January 1 of the next year because "[t]his argument improperly conflates the carrying charge rate issue with the timing of RBA recoveries...."[32] The CA also supports symmetrical interest rates for shortfalls and surpluses.

The County of Hawaii supports the CA's position that interest should reflect the marginal cost of providing capital and that this should be "the utilities' opportunity cost of working capital at the margin, which could be either the interest rate paid on the utility's short term debt or the interest rate earned on its short term investments."[33]

COH also responds to some of the arguments made by the HECO Companies. First, COH maintains that the RBA balance is

[31]CA Reply SOP at 12-13.

[32]CA Reply SOP at 11.

[33]COH Final SOP at 2 (citing CA Responses to Information Requests at 2-3).

not comparable to customer deposits. The County states that payment of accounts receivable is dependent on customers' good faith, ability to pay, and susceptibility to enforcement, while "payment" of RBA balances "is guaranteed by PUC-approved readjustment of rates from one year to the next to make up for a revenue 'shortfall' in one year."[34] According to COH, this is "not a comparable mechanism to giving customers 30 days to pay, with the risk that some will default."[35]

Second, COH observes that RBA balance revenue shortfalls are, in effect, a risk-free "loan" from the ratepayers to the utility.[36] Thus, "a risk-free rate of return for five to seventeen months is the appropriate rate of return on RBA balances."[37]

Third, COH does not agree that an appropriate rate of interest on RBA balances is the ROR because there is a significant difference between an amount (or account) receivable and the RBA balance carry-forward.[38]

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[34]COH Final SOP at 5.

[35]COH Final SOP at 5.

[36]COH Final SOP at 5.

[37]COH Final SOP at 5.

[38]COH Initial SOP at 6; COH Final SOP at 6-8.

In its Reply SOP, COH states that it is acceptable to use a single interest rate for both RBA balance shortfalls and surpluses, although it believes that symmetrical interest rates are "economically inappropriate" because:

> A shortfall would represent under-collection by the utility relative to the target such that ratepayers owe it money. On the other hand, a surplus represents money owed by the utility to ratepayers when actual revenues exceed the target. The former case represents a form of "loan" from the utility to ratepayers, the latter an involuntary "loan" from ratepayers to the utility.[39]

Blue Planet does not address this issue in detail, but states that "[i]nsofar as customer deposits may bear little direct relationship to achieving Hawaii's clean energy objectives, changes in the RBA outstanding balance interest rate may be appropriate, especially if the interest rate can be more closely linked with the clean energy purpose of decoupling, or to reflect market considerations possibly impacting the utilities' achievement of clean energy objectives."[40] Blue Planet also support symmetrical interest rates for positive and negative RBA balances.[41]

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[39]COH Reply SOP at 6.

[40]Blue Planet Final SOP at 8; see also Blue Planet Initial SOP at 2. HSEA supports Blue Planet's Final SOP with respect to Issue No. 1. HSEA Final SOP at 2.

[41]Blue Planet Final SOP at 8.

HREA generally supports the CA's position that the RBA interest rate should be based on short-term debt, but states that it "does not have an opinion as to what the RBA interest rate should be or whether it should be indexed in some manner, or whether the interest rate should be symmetrical."[42] In its Reply SOP, HREA states that it supports further discussion on this issue in Schedule B, but it views the rate as a benchmark rate to be tied to performance incentives or penalties.[43]

C.

Deferred Income Taxes

The CA raises an additional issue that is related to the interest rate issue: whether the HECO Companies may also be able to defer the payment of income taxes on the accrued amounts of decoupling revenues.[44] As explained by the CA in its Initial SOP:

> For example, if HECO accrues RBA revenues of $1,000 in year one because of declining sales and does not collect that revenue until the subsequent year, the cash flow foregone by the Company may actually be reduced by the deferred payment of income taxes on the $1,000, effectively reducing the required incremental working capital investment to a net-of-tax equivalent,

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[42]HREA Final SOP at 3.

[43]HREA Reply SOP at 5.

[44]CA Initial SOP at 6; CA Final SOP at 4.

> reduced by the composite effective federal and state tax rate of 38.91% or $611 ($1,000 - (1,000 * 38.91%) = $611). Any income tax deferral benefit arising from accrual of RBA revenues that are not immediately taxable should be recognized either by adjustment of the interest rate to a net-of-tax equivalent or through reduction of the RBA balance that earns interest to a net-of-tax equivalent amount. This income tax issue is being informally investigated with the HECO Companies. Preliminary indications are that the HECO Companies will include accrued/ uncollected RBA revenues within the HEI consolidated income tax returns as currently taxable income, which would not create the advantageous income tax deferrals discussed in this paragraph. The timing of income taxation associated with RBA accrued revenues should be investigated in connection with the Commission's re-examination of decoupling to ensure an accurate accounting for interest on the HECO Companies' actual net investment in additional working capital while awaiting recovery or refunding of RBA balances.[45]

The CA does not expand on this issue in its Reply SOP, but observes that any of the alternative approaches to the RBA interest rate discussed by the CA could be "applied to a net-of-income taxes RBA balance to account for potential income tax deferral on delayed RBA revenue recoveries."[46]

In their Reply SOP, the HECO Companies state:

> As an initial matter, it should be emphasized that the Consumer Advocate's suggestion is not the current state of how the Companies account for the RBA accrued

[45]CA Initial SOP at 6-7.

[46]CA Reply SOP at 5.

> revenues. For income tax purposes, the Companies treat RBA accrued revenues as taxable income with no book/tax difference. Consequently, there are no deferred income taxes associated with the RBA balance since the revenues or expense associated with the RBA balance are recognized in the same period for book and tax purposes.[47]

The HECO Companies state that the accrued revenues under the RBA represent the under-collection of revenues to which they are entitled, and, thus, for financial accounting purposes, they recognize these revenues since they are determinable and represent a valid claim under the tariff.[48] If the RBA account balance is over-collected, pursuant to the HECO Companies' interpretation of an Internal Revenue Service ("IRS") revenue ruling, the utility would not recognize the over-collected revenues as taxable income.[49] Conversely, when, as now, the utility is accruing under-collected revenues, the HECO Companies' believe that a "consistent application" of that same IRS revenue ruling is to recognize RBA accrued revenues for the under-collection.[50]

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[47]HECO Companies Reply SOP at 13.

[48]HECO Companies Reply SOP at 13-14.

[49]HECO Companies Reply SOP at 14-15. This position is based on the HECO Companies' understanding of a Federal Court of Claims case (Houston Industries, Inc., 125 F.3d 1442) and Revenue Ruling 2003-39 in which the IRS concluded that it would follow the Houston decision. Id. at 14.

[50]HECO Companies Reply SOP at 15.

The HECO Companies then state:

> In its SOP, the Consumer Advocate suggests that the Commission consider whether changing the tax accounting for the RBA account would be more beneficial by lowering the cost to the customer. In the current state of the RBA balance (under-collection), the potential deferral of the tax recognition of RBA revenues would be beneficial to the customer since the Companies would delay the payment of income taxes related to these revenues by approximately five months.
>
> The Companies' current tax method of following book recognition of RBA accrued revenues is a reasonable method that was adopted at inception and did not assume that the RBAs would be in a constant under-collection state. However, if the Commission should determine that the change proffered by the Consumer Advocate is reasonable and appropriate, the Companies are willing to apply with the IRS for a change in the accounting for the RBA accrued revenues. This would be a prospective change that would take effect as early as 2014, if approved by the IRS.[51]

D.

Issue No. 1 - Findings And Conclusions

Based on its review of the entire record and the recommendations of the parties, the commission finds and concludes as follows with respect to Issue No. 1:

[51]HECO Companies Reply SOP at 15.

1. The commission finds that the current interest rate applied to RBA balances of six percent was the result of negotiation and, as the CA observes, is not based on any measurement of the actual marginal cost of capital that may be associated with the RBA balances. Likewise, the commission finds that there are no statutory provisions that directly apply to the determination or establishment of specific interest rates on RBA balances.

2. All parties, with the exception of the HECO Companies, either favor or do not oppose changing the interest rate. Most favor utilizing a short term debt rate, although there is not agreement on how the short term rate to be utilized should be established. For example, among other alternatives, the CA recommends using FERC's AFUDC methodology, the COH recommends using either the interest rate paid on the utility's short term debt or the interest rate earned on its short term investments, and, assuming a short term debt rate is authorized, the HECO Companies recommend that the rate be established annually based on a 364 day short term debt estimate from the Companies.

Based on its review of the entire record and the recommendations of the parties, the commission finds that it is reasonable to utilize a short term debt rate for the RBA balances. While different methods of determining the short term debt rate are proposed by the parties, the commission is hereby ordering the HECO Companies to utilize the short term debt rate as established in deriving the consolidated cost of capital in each company's last full rate case.

The commission finds that use of this short term debt rate is consistent with principles espoused by the parties that support the use of a short term debt rate, and is easy to determine and apply as it remains constant until the next full rate case proceeding. The commission further observes that use of the short term debt rate from the immediately preceding full rate case is consistent with the use of the overall ROR in the surcharge calculations cited by the HECO Companies; that is, the ROR contains debt rates that may change from the rates used in the test year utilized in the last rate case.

3. Most parties supported the use of the same interest rate for both over- and under-collections of the RBA balances. While the commission does not agree that it is necessarily appropriate that these interest rates be the same for surpluses owed to ratepayers and for balances owed to the company, for purposes of this Order, the commission is authorizing use of the same interest rate for both surpluses and under recoveries. However, this issue is specifically subject to later review and adjustment by the commission in the Schedule B proceedings or a future docket.

4. The commission does not agree with the HECO Companies that the authorized ROR is an appropriate interest rate for the RBA balances. The HECO Companies cite a number of instances where the ROR has been utilized in surcharge applications; conversely, the CA cites a number of instances where a lower or zero interest rate has been used for certain regulatory deferral and recovery mechanisms.

Simply stated, the commission finds that an under-collected RBA balance is essentially a risk-free loan to the utility from the ratepayers, and, as noted by COH, is guaranteed to be repaid by a commission-approved adjustment of rates from one year to the next. In such circumstances, there is simply no merit to an argument that the risk of recovering this shortfall is equal to the overall risk facing the company's equity investors as reflected in the authorized rate of return. A similar conclusion applies to arguments that the RBA balance is similar to working capital.

5. Likewise, the commission does not agree with the HECO Companies' argument that utilization of the short term debt rate for the RBA balances is not appropriate because a portion of the CCOC already reflects the lower marginal cost of financing. As the Consumer Advocate observed, the determination of a short term debt rate to apply to outstanding RBA balances

does not depend upon an allocation of the various types of debt and equity.

The HECO Companies' argument here is unclear; there is no discernible linkage between the determination of an appropriate interest rate for the RBA balances and the consolidated cost of capital. Taken to its extreme, the argument would require that, for any interest rate associated with surcharges identified by the HECO Companies that utilize the ROR, an adjustment would have to be made to made to the short term debt rate, with the result that the interest rate on those surcharges could increase the ROR above the authorized level, a result that clearly would be neither just nor reasonable.

The commission also notes that outstanding RBA balances represent temporary over- or under- recovery of overall approved revenues. Outstanding RBA balances do not directly or solely represent utility expenditures that are eligible to earn a return at the utility's CCOC.

6. The commission is deeply concerned with the HECO Companies' response to the CA's observation that the HECO Companies may be able to defer the payment of income taxes on the accrued amounts of decoupling revenues. The HECO Companies concede that when the RBA balance is in a state of under-collection, the potential recognition of

RBA revenues would be beneficial to customers since the Companies could delay payment of income taxes on these revenues by approximately five months.

While the commission recognizes that this issue could cut both ways (that is, if there is a surplus to be returned to ratepayers, additional taxes might be due under the Companies' current practices), it is clear that this is an issue that could and should have been addressed and analyzed by the HECO Companies prior to or contemporaneous with the implementation of the decoupling mechanism. Surely, the Companies' auditing and tax departments are aware of the benefits of deferring taxes; stated differently, the Companies' knew or should have known that accrual of RBA balances could have deferred tax ramifications.

While the HECO Companies maintain that their method of accounting for RBA accrued revenues is reasonable, that is not the issue. As regulated utilities, the HECO Companies have a duty not only to act in a reasonable fashion, but in a manner which results in the greatest savings to ratepayers consistent with the provision of safe, adequate, and reliable service. The HECO Companies have clearly not acted so as to accomplish this goal with respect to the issue of deferred taxes.

The commission is hereby directing the HECO Companies to immediately investigate the possibility that they may be able to defer the payment of income taxes on the accrued amounts of decoupling revenue, and report the results of that investigation, along with recommendations as to deferred tax treatment, to the commission and the parties within one-hundred and twenty (120) days of this Order. Nothing in this Order, however, shall be construed as a finding that such changes may only be made on a going forward basis; the commission is expressly retaining jurisdiction to determine in the next decoupling and rate case filings whether each Company's allowed income taxes should be adjusted to account for the failure to address the deferred tax issue raised here in a timely fashion.

IV.

Issue No. 2 - Is It Reasonable To Automatically Include All Actual Prior Year Capital Expenditures On Baseline Projects In RAM Ratebase?

As set forth in Order No. 31635, Issue No. 2 is as follows:

2. REASONABLENESS OF AUTOMATICALLY INCLUDING ALL ACTUAL PRIOR YEAR EXPENDITURES ON BASELINE PROJECTS IN RAM RATEBASE:

   a. Do the existing RAM provisions which use recorded end-of-year net plant in service for the determination of RAM rate base adjustments allow for recovery of revenues associated with capital expenditures not previously reviewed and approved by the Commission or allowed as RAM adjustments in prior years? If so, is this reasonable and in the public interest?

b. Are these provisions consistent with the principles presented and considered in the Decoupling Docket that annual RAM period plant additions should be based on the sum of Major Projects and a five-year moving average of Baseline Projects?

c. Are there feasible alternatives to the current use of recorded year-end balances in the determination of plant additions and other adjustments used to determine the effective RAM net ratebase (including, for example, depreciation, amortization, accumulated deferred income taxes and contributions in aid of construction) that would preserve the principles enunciated in the Decoupling Docket to base RAM period plant additions on Major Projects plus a five-year moving average of Baseline Projects?

d. If it is not feasible to implement alternatives to the current use of year end balances in the determination of RAM period net rate base, should the amount of RAM adjustments or some components of RAM adjustments be frozen at 2013 levels or some other level until some or all of the related issues in this docket are resolved?

A.

The Current Practice

The Decoupling Docket characterized the rate base component of the RAM adjustment as being based on plant additions equal to a sum of actual major projects pursuant to General Order No. 7 and a five year moving average of "baseline" capital additions (excluding the major projects). This was described as a reasonable "budget" for increases in the amount of capital expenditures between rate cases.

In order to provide accountability, the RAM tariff specifies that the plant in service amount used as the starting point in calculating the RAM adjustment is to be based on the prior year's actual recorded end-of-year balance, to which following year (RAM year) major project and baseline project plant additions are then added and to which depreciation, amortization, ADIT and CIAC adjustments (also based on actual recorded end-of-year amounts) are ultimately made to determine average RAM year rate base.

In Order No. 31289, the commission expressed concern regarding the recent trend of HECO's increasing expenditures for utility plant. The commission observed that the majority of the expenditures appear to be related to baseline projects that are not subject to any prior commission review and approval process, in contrast to major capital projects that are subject to the commission's General Order No. 7, Standards for Electric Utility Service in the State of Hawaii.[52] For example, in Order No. 31289, the commission observed that HECO's 2013 decoupling tariff filing reflected considerable increases in total plant investments (including baseline and major project plant

[52]Order No. 31289 at 14-15.

additions) since HECO's first decoupling filing - jumping from $170 million in 2011 to $256 million in 2012, and to $292 million projected for 2013.[53]

B.

The Parties' Positions With Respect To The Inclusion Of Baseline Projects In RAM Ratebase

The HECO Companies begin their discussion of this issue by observing that the current method is the method recommended by the CA, and go on to state that the use of actual balances for the beginning-of-year balances is a desirable feature of the rate base RAM that is consistent with standard regulatory practice.[54] The HECO Companies then maintain that use of beginning year balances is inherently conservative because the baseline plant additions estimate is based on a five-year average, and not a trended estimate (as originally proposed by the HECO Companies).[55] The estimate does not incorporate the impact of inflation, and does not include any baseline project investment growth in excess of the five-year average.[56]

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[53]See Order No. 31289 at 14, fn. 18,

[54]HECO Companies Final SOP at 7.

[55]HECO Companies Final SOP at 8.

[56]HECO Companies Final SOP at 8-9. The HECO Companies make a number of comments with respect to projects that are subject to General Order No. 7 as well, observing that only projects subject to, and approved under, General Order No. 7, that are

The HECO Companies appear to recognize that one of the underlying concerns of the commission is the growth in the plant balance for Hawaiian Electric, particularly the baseline additions component of plant, and the "perception" that there should be "more review" of these amounts before including them in the RAM.[57] In response, the HECO Companies make a number of arguments.

First, the HECO Companies state that the plant additions, for which costs are recovered between rate cases through the RAM, are essential to the reliable operation of the grid, and the integration of renewable energy generation. Moreover, at the time decoupling was implemented, it was known that HECO would have to significantly expand its investment in the grid, and that this would impact the RAM.[58]

Second, the HECO Companies observe that there are specific consumer protections built into the process:

> The decoupling mechanism includes Major Capital Projects Credits and Baseline Capital Projects Credits (plus interest) will be returned to customers for any amounts of Major Capital Projects costs that the Commission disallows for cost recovery, and for specific baseline capital projects

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expected to go into service in the first three quarters of the year are included in the major project estimate. Id. at 9, see also Exhibit 1 at 8.

[57]HECO Companies Final SOP, Exhibit 1 at 12-15.

[58]HECO Companies Final SOP at 40-43.

> (i.e., capital projects less than the G.0.7 threshold of $2.5 million) that are disallowed by the Commission in a subsequent rate case if the disallowance reduces actual Baseline Capital Projects costs below the Baseline Capital Projects cost estimate.[59]

Third, by March 31st of each year, the HECO Companies are required to file a report that includes: (1) for projects less than $1 million, the total number of projects completed and the total cost associated by asset category for those plant additions; (2) for projects between $1 million and $2.5 million, an itemization for each completed project that includes the actual costs incurred, with an explanation of any deviations of plus or minus fifteen percent from the budgeted cost, and a general discussion of the reasons causing the variance; and (3) for projects of $2.5 million or more, the identity of each completed project and its total cost.[60] The Companies state that they have followed the established regulatory process and "should not be penalized after the fact for expending at or about the reported levels (by under-recovery of the return on and return of actual plant additions)."[61]

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[59]HECO Companies Final SOP at 9.

[60]HECO Companies Final SOP at 11 and Exhibit 1 at 19; HECO Companies Initial SOP at 44 and Exhibit B.

[61]HECO Companies Initial SOP at 48; HECO Companies Final SOP, Exhibit 1 at 19

Fourth, the HECO Companies request that if any changes are made to this system, they should be made prospectively and not retroactively.

Fifth, the HECO Companies propose to discuss expanding the process for reporting on the level of baseline capital expenditures, as summarized in their Reply SOP:

> To facilitate the review of baseline capital expenditures and plant additions in the capital expenditures budget presentations, and to provide an opportunity for the Commission to provide feedback on the proposed level of expenditures, theCompanies have developed a proposed iterative process for future presentations. The proposed process is described in Exhibit 2 to the Companies' SOP. A key element of the proposed process is the provision of more detailed information on baseline projects, included estimated revenue requirement impacts, and the provision of such information at a much earlier date so that the Companies can make adjustments based on the feedback if appropriate.[62]

This proposal comes with two significant caveats. First, at oral argument, the Companies conceded that they viewed this proposal as a quasi pre-approval of baseline projects. (HECO Companies, Tr. 55). Second, the HECO Companies are not necessarily proposing to implement this proposal now;

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[62]HECO Companies Reply SOP at 18.

as described by the Companies, "[t]he proposal is just that - a proposal" that is, apparently, subject to further discussion.[63]

In their Reply SOP, the HECO Companies conclude that the positions of other parties are consistent with the Companies' positions on these issues. First, the HECO Companies state that the parties agree that the existing RAM provisions are reasonable and in the public interest because they result in credible and conservative estimates of the largest Rate Base RAM components with safeguards included to protect ratepayer interests consistent with Commission-ordered disallowances.[64]

Second, the parties also agree that the inclusion of the sum of Major Capital Projects and a five-year rolling average of baseline projects in the Rate Base RAM is consistent with the principles presented and considered by the Commission in the Decoupling Docket.[65]

Third, there were no alternatives to the calculation of Rate Base RAM proposed by the parties to be effective as a result of the consideration of Schedule A issues, and, any such alternatives and changes should be considered along with the Schedule B issues.[66]

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[63]HECO Companies Reply SOP at 18, fn. 30.

[64]HECO Companies Reply SOP at 18-19.

[65]HECO Companies Reply SOP at 20-23.

[66]HECO Companies Reply SOP at 24-26.

As stated by the HECO Companies, the Consumer Advocate essentially agrees that there should be no change in the treatment of baseline projects in this phase of this docket. The CA does agree that "as currently implemented, the existing RAM provisions do result in the recovery of revenues associated with capital expenditures not previously reviewed and approved by the Commission."[67] However, the CA also maintains that consumer safeguards have been built into the system:

> Baseline and Major Capital Projects included in RAM Rate Base are subject to regulatory review and retrospective adjustment of previous RAM recoveries if specific problems are identified and cost disallowances are later ordered by the Commission. The RAM tariff provides for Major Capital Projects Credits and Baseline Capital Projects Credits to provide for reduction to prior years' RAM Revenue Adjustments should any specific major or baseline capital projects become the subject of disallowances in subsequent rate cases. These provisions recognize the potential for capital project disallowances after the completion of regulatory audits or other reviews and serve to ensure that ratepayers are refunded any amounts inappropriately collected through RAM as a result of subsequent Commission findings. Under such circumstances, the approved RAM does include safeguards to protect ratepayer interests consistent with any Commission ordered disallowance.[68]

The CA further states that the inclusion of the sum of Major Capital Projects and a five-year rolling average of

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[67]CA Final SOP at 12.

[68]CA Final SOP at 15-16.

baseline projects in the Rate Base RAM are intentional, reasonable, and in the public interest.[69] According to the CA, these provisions provide both accuracy and accountability, and are more objective and reliable than company forecasts that would be used in other methods.[70] Moreover, the RAM mechanism safeguards (as set forth in the above quoted language) mitigate the risk of excess recoveries by utility. The CA also states that the recent high amounts of baseline plant additions observed by the commission would, in absence of the RAM as presently structured, be a reason for more frequent rate case filings; stated differently, the end of year plant in service provisions serve to mitigate rate case frequency.[71]

The CA concedes that there are alternatives to the current use of recorded year-end balances. For example, a modification to RAM that imposed generalized inflation rate limitations may assist in protecting ratepayers from outsized Target Revenue increases, assuming general rates of inflation remain moderate.[72]

> RAM modifications that substitute external price indices or impose limitations on price changes over multiple RAM years

[69]CA Final SOP at 15.

[70]CA Initial SOP at 13-14.

[71]CA Initial SOP at 17.

[72]CA Final SOP at 20.

> (with no rate case opportunity as a regulatory backstop) could incent the HECO Companies to reduce costs in order to maximize earnings. Aggressive cost controls stimulated by such changes, on the other hand, may inadvertently jeopardize service quality and/or the utility's willingness and ability to support renewables deployment and other strategic initiatives. The specific design of any RAM modifications using external drivers or limitations would need to consider and carefully balance ratepayers' interests in safe and reliable service, as well as clean energy initiatives, all at just and reasonable rates In both the short and longer term.

However, such modifications would also "increase the risk that sustained utility cost increases above general rates of inflation would reduce the utility's financial performance to unacceptable levels and expose ratepayers to more frequent and larger general rate cases, or both."[73] The CA maintains that there is not enough time to formulate viable alternatives under the Schedule A procedural schedule, and, therefore, recommends deferring this issue to be further considered along with the Schedule B issues.[74]

The CA also noted that in the Decoupling Docket, two other alternatives were considered: (1) rate base could be developed entirely from estimated (i.e., budget or forecast) data or (2) available actual data could be used in place of

[73]CA Final SOP at 20.

[74]CA Final SOP at 21.

forecasts whenever possible.[75] However, these were rejected in favor of the present methodology because calculating the Rate Base RAM is easier under the present methodology, and because of the time constraints associated with the review of the annual decoupling filing.[76] The CA also observes that freezing Rate Base RAM at 2013 levels would protect ratepayers in near term, but would ultimately result in more frequent rate cases.[77]

In its Reply SOP, the Consumer Advocate states that it generally agrees with the HECO Companies' positions with respect to this issue, and that if alternatives are to be considered, they should be considered in the Schedule B proceedings:

> The Consumer Advocate does not dispute [the HECO Companies'] claims, but observes that it may be possible in Schedule B of this docket to improve upon the mechanical procedures employed to account for capital investment changes within the rate base RAM. However, the inherent complexity and financial importance of Rate Base RAM accounting procedures requires that any modifications be implemented only after careful analysis and vetting, to protect against unreasonable outcomes.
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> * * * * * * * *
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> The Consumer Advocate welcomes the opportunity within the Schedule B portion of this Docket to examine alternative approaches to RAM that may prospectively

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[75]CA Final SOP at 19.

[76]CA Final SOP at 19.

[77]CA Final SOP at 21-22.

> account for capital spending in ways that more effectively encourage and reward management efficiency, producing just and reasonable rates without compromising service quality or public safety between rate cases.[78]

The County of Hawaii states that it "believes using 'recorded end-of-year net plant in service for the determination of Rate Base RAM adjustments (to) allow for recovery of revenues associated with capital expenditures not previously reviewed and approved by the Commission or allowed as RAM adjustments in prior years' appears reasonable."[79] However, in its Reply SOP, the County questions whether decoupling is necessary, but states that if there is a reason that supports decoupling, it is that there is an attempt to simulate market conditions by shortening the time between investment and financial return for the utility.[80] The County further states that it supports mechanisms that move "Hawaii's electricity system closer to a more market-and performance-driven approach, with pricing mechanisms that accurately reflect underlying cost structures, marginal production costs, proper dispatch, and appropriate

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[78]CA Reply SOP at 15-16.

[79]COH Final SOP at 8-9.

[80]COH Reply SOP at 6.

operations and maintenance expenditures" and that balances ratepayer and shareholder interests.[81]

Blue Planet does not have a specific recommendation with regard to this issue, but supports exploring whether and to what extent the RBA adjustment should be modified to aid in the achievement of Hawaii clean energy objectives.[82] "HREA does not have an opinion as to whether the inclusions of 'recovery of revenues associated with capital expenditures not previously reviewed and approved by the Commission or allowed as RAM adjustments in prior years' is reasonable and in the public interest."[83]

C.

Issue No. 2 - Findings And Conclusions

Based on its review of the entire record and the recommendations of the parties, the commission finds and concludes as follows with respect to Issue No. 2:

1. As discussed in Order No. 31289, the commission has serious concerns regarding the recent trend of HECO's increasing expenditures for utility plant. As stated

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[81]COH Reply SOP at 7.

[82]Blue Planet Final SOP at 8. HSEA supports Blue Planet's position on this issue. HSEA Final SOP at 2.

[83]HREA Final SOP at 3.

previously, the majority of the expenditures are related to baseline projects that are not subject to prior commission review and approval, unlike major capital projects that are subject to the commission's General Order No. 7. Given this fact, the commission has serious concerns about whether the HECO Companies have the appropriate incentives to minimize these costs.

2. Indeed, in the recent Decision and Order pertaining to MECO's rate case, the commission expressed concern that, without a sustainable business plan, there was no strategic framework under which to evaluate capital expenditure programs:

> From the commission's perspective, the HECO Companies appear to lack movement to a sustainable business model to address technological advancements and increasing customer expectations. The commission observes that some mainland electric utilities have begun to define, articulate and implement the vision for the "electric utility of the future." Without such a long-term, customer focused business strategy, it is difficult to ascertain whether HECO Companies' increasing capital investments are strategic investments or simply a series of unrelated capital projects that effectively expand utility rate base and increase profits but appearing to provide little or limited long-term customer value. While a public utility is required to have a reasonable opportunity to earn a fair financial return, attractive

> financial returns are not an entitlement by virtue of being a regulated utility.[84]

3. All of the parties appear to support the current method based on one or more of the following factors: (a) it is conservative; (b) it is easy to compute; (c) it provides accuracy and accountability, and/or (d) it is more objective and reliable than company forecasts that would be used in other methods. Nevertheless, both the Consumer Advocate and, to some extent, the HECO Companies, recognize that baseline projects that have not been subject to review are included in the calculation. For example, the CA states that "[a]s currently implemented, the existing RAM provisions do result in the recovery of revenues associated with recorded capital expenditures within Utility Plant in Service accounts that were not previously reviewed and approved by the Commission."[85] For their part, the HECO Companies propose to discuss providing additional information concerning baseline projects, as further discussed below.[86]

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[84]"In the Matter of the Application of MAUI ELECTRIC COMPANY, LIMITED, For Approval of Rate Increases and Revised Rate Schedules and Rules," Docket No. 2011-0092, Decision And Order No. 31288, filed May 31, 2013, Exhibit C, Commission's Observations and Perspectives, page 3 of 6.

[85]CA Final SOP at 12.

[86]HECO Companies Reply SOP at 18 and fn. 30.

4. The parties variously claim that the Rate Base RAM is conservative because: (a) it does not fully remove regulatory lag; (b) it does not fully account for project baseline expenditures because there is no inflation adjustment or recognition of increasing capital needs in the five-year moving average; and (c) it does not guarantee full recovery of utility costs. The commission finds that this view is too narrow and ignores a more relevant comparison: decoupling versus traditional ratemaking.

Under traditional ratemaking concepts, the utility will experience regulatory lag, is not guaranteed full recovery of allowed revenues, and will not receive explicit allowances for recovery of capital expenditures above allowed test year levels on which current rates are based until the next general rate case. This is not the case with respect to the Rate Base RAM.

Thus, the issue is whether the RAM must be fully compensatory of every capital cost incurred between rate cases, adjusted for inflation, without regulatory lag, and without regard to incentives, or, on the other hand, whether the RAM should provide timely recovery of revenues for expenditures between rate cases with at least some incentive to control those expenditures, aside from reviewing them after the fact in a full, future rate case. The commission finds that the latter approach is more consistent with the fundamental principle that rates should be just and reasonable.

5. The commission further observes that the RAM was predicated upon 3 year rate case cycle. The commission notes that the HECO Companies may be diverging from this process. For example, pursuant to a settlement agreement, HELCO's most recent rate case was withdrawn. To the extent this trend continues, that is, in the absence of a three year rate case cycle, baseline capital expenditures will continue to grow between rate cases. Thus, significant sums will be spent before any full rate case scrutiny, which, under these circumstances, may occur many years down the road.

6. None of the parties advocate that the commission order any changes to the current tariffs in this Order. The Consumer Advocate did observe that there could be alternatives to the current mechanism to improve upon the mechanical procedures used to account for capital investment changes within the rate base RAM. For example, the CA states that the overall increase to certain discrete elements of RAM could be limited by some general measure of inflation each year so as to strengthen the financial incentives for each utility to carefully manage costs between rate cases.[87]

[87]CA Final SOP at 20.

7. The HECO Companies and the Consumer Advocate recommend that any changes to the Rate Base RAM mechanism (as well as any changes related to Schedule A Issue No. 3 as further discussed in Section V of this Order), should be deferred and considered with the Schedule B issues in this proceeding. Both parties recommend caution regarding changes to the Rate Base RAM provision that uses recorded end-of-year balances in the determination of RAM adjustments.

8. The commission observes that Rate Base RAM is the only component of the decoupling mechanisms that is indexed on utility expenditures, with the result that increased expenditures directly result in increased allowed revenues. In sharp contrast, the RBA and O&M RAM are based on approved revenues indexed on factors that do not vary as a result of the amount of utility expenditures. The RBA and O&M RAM components of the decoupling mechanisms thus preserve one of the facets of traditional ratemaking: that reductions in utility expenditures between general rate cases (i.e., cost control) result, on the margin, in increased utility earnings. This is not the case for Rate Base RAM, particularly the baseline capital component, which allows incremental utility expenditures to flow directly through to incremental RAM revenues, thus removing this incentive to the utility to control costs.

9. For the above reasons, and in conjunction with its findings concerning risk sharing as discussed in Section V of this Order, the commission finds that the continued application of the current Rate Base RAM tariffs does not result in rates that are just and reasonable as it does not incentivize cost control. Accordingly, the commission is requiring certain modifications to those tariffs in this Order, and directing the parties to further explore these issues in conjunction with other risk sharing mechanisms discussed in Section V of this Order in the proceedings relating to Schedule B issues.

10. Specifically, the commission agrees and finds that the concerns identified here, particularly with respect to concerns regarding maintaining and enhancing the utility's incentives to control costs and appropriately allocating risk and compensation for risk, should be further considered and addressed in detail by the parties in the Schedule B proceedings. Further, the commission is clarifying that the parties should develop mechanisms for the commission's consideration that provide the utilities with incentives to control costs, including, but not limited to, an examination of the general approach proposed by the Consumer Advocate to adjust the ROE applied in the RAM based on one or more appropriate measure(s) of utility cost control performance (as further discussed in Section V of this Order).

Until any such mechanisms are reviewed and implemented, the existing RAM provisions shall be maintained, including use of end-of-year recorded balances as currently provided in the RAM tariffs, with the following modifications. These modifications are intended to serve as an interim measure to at least partly mitigate the untenable characteristic of the existing RAM that allows the utilities' baseline expenditures to flow through the Rate Base RAM Adjustment fully and directly to increase allowed target revenues without prior review or approval by the commission and without the same measure of cost control incentives as provided by the other components of the RAM and RBA tariffs.[88]

The commission orders the HECO Companies to revise their decoupling tariffs to provide that the amount of any "Rate Base RAM - Return on Investment Adjustment" ("Rate Base RAM Adjustment") applied to the determination of Target Revenues and the RBA Rate Adjustment in accordance with the existing RAM tariffs shall include the entire effective Rate Base RAM Adjustment from the prior year, plus ninety percent of the amount that the current RAM Period Rate Base RAM Adjustment exceeds the Rate Base RAM Adjustment from the prior year.

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[88]See Finding No. 8 above regarding the lack of cost control incentives in the Rate Base RAM provision compared to other components of the RAM and the RBA tariffs.

If the prior year is a rate case test year, the amount of the Rate Base RAM applied to the determination of Target Revenues and the RBA Rate Adjustment shall be ninety percent of the RAM Period Rate Base RAM Adjustment.

The commission observes that this change should not result in any adverse impacts to the Companies regarding recovery of revenues allowed in the Stipulated Settlement Agreement. The 2013 RAM Period Rate Base RAM Adjustment, which is fully allowed in the determination of 2014 RAM Period Target Revenues, provides for full recovery of revenues for return on investment and associated taxes related to allowed CIS and CT-1 plant additions attributable to the Stipulated Settlement Agreement.

The HECO Companies are directed to file amended RAM tariffs implementing the provisions identified above by March 1, 2014, and shall apply these provisions to the decoupling submittals required on or before March 31, 2014.

11. The commission appreciates the HECO Companies' proposal to discuss providing the commission and the parties with more detailed information on baseline projects, including estimated revenue requirement impacts, and to provide such information at a much earlier date so that the Companies can make adjustments based on any feedback, if appropriate. However, the commission stresses that the provision of

such information in no way should be construed as any type of quasi- or pre-approval of baseline projects. Approval of such projects remains an issue to be addressed in full rate case proceedings.

V.

Issue No. 3 - Should A Risk Sharing Mechanism Be Incorporated Into The RBA?

As set forth in Order No. 31635, Issue No. 3 is as follows:

> 3. RISK SHARING MECHANISM:
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> Should the amount of the RBA adjustments to target revenues be reduced by some fraction to re-distribute financial risks or create incentives/penalties for the utility to control costs in response to sales and demand volume reductions?

A.

The Parties' Positions With Respect To The Implementation Of An RBA Risk Sharing Mechanism

The HECO Companies position is unequivocal: "No adjustment should be made to reduce the RBA adjustment to re-distribute financial risks or create additional incentives/ penalties for the Companies to control costs."[89] The HECO Companies maintain that (1) the decoupling mechanism is

[89]HECO Companies Reply SOP at 26; see also HECO Final SOP at 14-15.

intended to allow the Companies to achieve their target revenues between rate cases to "conservatively" account for inflation in certain operations and maintenance expenses, and in the return on and of the Companies' investments in their infrastructure; (2) the return on equity was adjusted downward by 50 basis points to compensate ratepayers for the "risk-reducing" effects of the RBA and RAM, as well as other automatic adjustment mechanisms; (3) the target revenues as currently calculated are already conservative; and (4) any RBA adjustment would be inconsistent with the Stipulated Settlement Agreement.[90]

The HECO Companies essentially repeat these arguments in their Reply SOP.[91] Additionally, they observe that the CA is concerned that "a significantly revised alternative regulatory framework that has not been thoroughly vetted may result in unintended and/or undesirable consequences, and that further reducing target revenues by some fraction to shift risks to shareholders and/or to create cost control incentives may undermine the fundamental purpose of RAM, which is to conservatively simulate rate case outcomes while avoiding more frequent and larger rate cases."[92]

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[90]HECO Companies Final SOP at 14-15; HECO Companies Initial SOP at 10-11, 54-56.

[91]HECO Companies Reply SOP at 26-28.

[92]HECO Companies Reply SOP at 27-28 citing CA Final SOP at 24-25.

To be sure, the CA does state, in its Final SOP, that "implementation of a significantly revised alternative regulatory framework for the HECO Companies, based upon new financial and performance measures and calculations methodologies, that has not been thoroughly vetted, may result in unintended and/or undesirable consequences."[93] This statement is made in conjunction with the CA's proposal concerning ROE adjustments:

> One remaining problem with the RAM in its present form is the allowance of the same ROE each year, regardless of management efficiency or resulting rate and service quality levels. The Consumer Advocate continues to favor the thoughtful development of an alternative regulatory framework that provides an opportunity for the utility to earn relatively higher ROE levels whenever the calculated overall revenue requirement change each year is constrained to not exceed general inflationary levels, but lower ROE levels whenever overall utility costs are not controlled within such general inflationary boundaries. Such variable returns should be designed to share the benefits of utility cost controls, but must also be tempered by appropriate service quality performance and clean energy achievement metrics that are under consideration by the Commission in this Docket.
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> The Consumer Advocate believes that it may be possible to revise the existing RAM calculations to provide for a variable and

[93]CA Final SOP at 24-25.

> somewhat higher ROE when overall revenue requirement increases are lower than general inflation, and vice versa when unreasonably large cost increases are experienced, assuming that service quality and other measures of utility performance do not deteriorate as a result of cost control measures that are stimulated by regulatory changes. The Consumer Advocate is willing to work collaboratively toward a carefully designed and calibrated variable ROE approach to rebalance ratepayer and shareholder interests, that does not adversely affect the HECO Companies' ability to offer reliable, safe and reasonably priced utility service while maintaining utility access to capital on reasonable terms.[94]

The CA's position in its Reply SOP is the same. The CA concludes: "[t]he Consumer Advocate invites more detailed specification by the Commission within its Schedule A Order, detailing how any new fractional reduction or risk sharing measures might be implemented, so the Parties can more thoroughly investigate such proposals within Schedule B of this docket."[95]

The County of Hawaii states that it "is appropriately concerned about shifting ever more financial risks to ratepayers, as well as the consequences of decoupling regarding incentives to control costs," and, therefore, supports implementing some form of risk sharing, although it

[94]CA Final SOP at 24, 25-26.

[95]CA Reply SOP at 18.

does propose a specific mechanism.[96] In its Reply SOP, COH discusses the concept of shared risk in detail, observing, among other things, that:

> As stated previously in the County's [Initial SOP], financial risks should be readjusted. For the sake of increased renewable energy and efficiency, multiple parties in this docket promote decoupling and RBA/RAM mechanisms to shift revenue risk from utilities to ratepayers. The County respectfully suggests this is not a virtuous outcome, and is one that harms individual well-being as well as growth of new business opportunities and a diversified economy for Hawaii's people, many who have already conserved their electricity usage to a bare minimum....
>
> The County does not begrudge the HECO companies success, and applauds all businesses that thrive in Hawaii's often challenging business environment. The County does question, however, why an ever-expanding list of business risks should be transferred from the utility to its customers.[97]

The County goes on to state that utilities are already shielded from numerous risks, through mechanisms such as the ECAC, the PPA, the REIP, and others.[98] In light of these and the decoupling mechanism, the County asks how much risk ratepayers are expected to assume, and observes that no analyses have been

[96]COH Final SOP at 9.

[97]COH Reply SOP at 10.

[98]COH Reply SOP at 11.

provided to demonstrate that the decoupling model is sustainable.[99]

Blue Planet states that a risk sharing adjustment may be appropriate "only to the extent it is directly related to achieving Hawaii's energy objectives" and notes that "[n]ear-term investments in long term clean energy infrastructure may not be directly proportional to sales and demand volume."[100] HREA states that it agrees with the CA's position to explore the possibility of adjusting the ROE to provide incentives for utility cost control.[101]

B.

Issue No. 3 - Findings and Conclusions

Based on its review of the entire record and the recommendations of the parties, the commission finds and concludes as follows with respect to Issue No. 3:

1. The commission finds that, at this juncture, it is appropriate to further investigate whether risk is appropriately allocated between the HECO Companies and their customers under the current decoupling mechanism, or whether

[99]COH Reply SOP at 11.

[100]Blue Planet Final SOP at 8. HSEA supports Blue Planet's position on this issue. HSEA Final SOP at 2.

[101]HREA Final SOP at 6.

some adjustment should be made. In addition, as discussed in Section IV above, as risk is currently allocated, there does not appear to be an effective incentive for the HECO Companies to control certain costs, including baseline project costs.

2. In conjunction with its finding with respect to Issue No. 2 in Section IV of this Order, the commission finds that the concerns identified here, particularly with respect to concerns regarding maintaining and enhancing the utility's incentives to control costs and appropriately allocating risk and compensation for risk, should be further considered and addressed in detail by the parties in the Schedule B proceedings. Among other things, the parties should investigate the possibility of implementing an alternative regulatory framework, as posited by the CA, that provides an opportunity for the utility to earn relatively higher ROE levels whenever the calculated overall revenue requirement change each year does not exceed general inflationary levels, but lower ROE levels whenever overall utility costs are not controlled within such general inflationary boundaries.

3. Pending completion of the Schedule B proceedings, the commission finds and concludes that the modifications to the Rate Base RAM required with respect to Issue No. 2 in Section IV of this Order address, in part and on an interim basis, the commission's concerns with respect to risk sharing.

As suggested by the commission in its questions to the parties during oral argument, there is a direct relationship between Issue Nos. 2 and 3, which should be further explored in the Schedule B proceedings.

VI.

Issue No. 4 - Should Certain Metrics Be Adopted In The Schedule A Order?

As set forth in Order No. 31635, Issue No. 4 is as follows:

4. PERFORMANCE METRICS:

> Should metrics be determined to measure utility performance that would be reported on a regular basis to the commission and made available to the general public? What metrics are appropriate? What relationship, if any, should such metrics have to performance incentives?

In Order No. 31484, the commission clarified a distinction between the performance metrics to be addressed in Schedule A and the performance incentives to be considered in Schedule B.

> The consideration of performance metrics in Schedule A are distinct from the performance incentives identified as an issue for consideration in Schedule B. The performance metrics considered in Schedule A would be metrics to be regularly reported by the utilities without further direct linkage to financial or other incentives. The performance incentives considered in Schedule B may ultimately incorporate performance metrics as part of

> the incentive mechanisms but these metrics would not necessarily be the same as the metrics determined as reporting requirements in Schedule A.[102]

A.

The Parties' Positions With Respect To Performance Metrics

The parties identify and discuss a wide variety of metrics and express a range of opinions regarding which of the identified metrics are feasible and appropriate to be reported on a regular basis and made available to the commission and the general public.

The HECO Companies initially opposed requirements for providing performance metrics as a part of Schedule A.

> Issues related to performance metrics should be deferred to Schedule B. The Companies are already subject to numerous reporting requirements, and the addition of new reporting requirements in Schedule A would not serve a useful purpose.[103]

The HECO Companies provided a list of currently required reports related to performance metrics and energy agreement initiatives as Exhibit B to their Initial SOP.

On further consideration, in their Final SOP and Reply SOP, the HECO Companies provided a list of proposed

[102]Order No. 31484, footnote at 8.

[103]HECO Companies Initial SOP at 11; HECO Companies Final SOP at 15.

Schedule A performance metrics which could be implemented through this Order.

> After reviewing the other Parties' proposed Schedule A performance metrics in their ISOPs and responses to information requests ("IRs"), the Companies submitted proposed Schedule A performance metrics to be filed under a Performance Metrics Report covering the following areas: transmission and distribution ("T&D") system reliability; generator reliability; renewable energy; customer service; financial performance; and employee safety.... The Companies' metrics represent the core business areas of the Companies and are generally consistent with the metrics used in the electric industry.[104]

Exhibit 3 of the HECO Companies' Final SOP specifies the performance metrics that the Companies propose to include in a quarterly "Performance Metrics Report."[105] This Exhibit includes table identifying performance metrics, indicating how and how often the performance metrics would be calculated, and provides a detailed discussion of several categories of the proposed performance metrics.

The performance metrics proposed by the HECO Companies in Exhibit 3 are:

<u>Transmission and Distribution</u>

1. System Average Interruption Duration Index (SAIDI)

2. System Average Interruption Frequency Index (SAIFI)

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[104]HECO Companies Reply SOP at 30; <u>see</u> <u>also</u> HECO Companies Final SOP at 16.

[105]HECO Companies Reply SOP at 30.

Power Supply/Generation

1. Equivalent Availability Factor (EAF)

2. Equivalent Forced Outage Rate-Demand (EFORD)

3. Equivalent Forced Outage Factor (EFOF)

4. IPP Energy / Net to System Energy

Renewable Energy

1. System Renewable Energy Metric (System RE Metric)

2. Renewable Portfolio Standard Compliance

3. Total Renewable Energy Metric (Total RE Metric)

4. Number of NEM program participants and capacity of NEM program

Customer Service

1. Percentage of customer calls answered within thirty seconds

2. Customer Transaction Survey Results

Financial

1. Return on Equity Ratemaking

2. Credit Rating - Standard & Poors

3. Credit Rating - Moody's

Employee Safety

1. Total Case Incident Rate (TCIR)[106]

The HECO Companies also summarized their responses to the performance metrics proposed by other parties Initial SOPs in a table provided as Exhibit 4 to the HECO Companies Final SOP. An updated table summarizing the HECO Companies' responses to the performance metrics proposed by the other parties in their Final SOPs is provided as Exhibit 1 to the HECO Reply SOP.[107]

The Consumer Advocate maintains that it is reasonable to establish metrics[108] and provides a list of proposed metrics, emphasizing three areas: reliability, safety and customer satisfaction.[109] In its Final SOP, the Consumer Advocate addresses the HECO Companies' initial opposition to providing Schedule A performance metrics, arguing that since the HECO Companies already collect and present pertinent information in various reports, it should not be burdensome to compile some performance metrics:

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[106]HECO Companies Final SOP, Exhibit 3

[107]This table was used by the commission during oral arguments to assist with clarification of the parties' positions regarding each of their proposed performance metrics. Tr. 82-83.

[108]CA Initial SOP at 20; CA Final SOP at 26.

[109]CA Initial SOP at 20-24 and table at 22-34; CA Final SOP at 26-27.

> The HECO Companies' ISOP explains that, "[tjhere are already 'metrics' reported to the Commission on a regular basis through formal and informal reports, and it should not be necessary to create new metrics for Schedule A." The Consumer Advocate ISOP recognizes that the utilities maintain statistical data responsive to many of these performance metrics and that this data is typically presented in rate case filings and in other formal and informal submittals. However, since the Commission's orders identify Performance Metrics as relevant to the re-examination of decoupling, the Consumer Advocate believes that the HECO Companies' existing performance data could, or should, be re-evaluated and formatted into useful summaries with graphical displays showing actual performance trends relative to established targets in each measurement area that is deemed relevant to decoupling. To the extent that this information is already maintained and compiled by the HECO Companies in the normal course of business, the presentation of this same information in another venue should not be burdensome.[110]

The Consumer Advocate also argued for development of reasonable performance metrics pertaining to Hawaii's clean energy initiatives.[111]

In its Reply SOP, the Consumer Advocate generally supports the HECO Companies' Schedule A performance metrics ultimately proposed by the Companies in the HECO Companies Final SOP, Exhibit 3.

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[110]CA Final SOP at 27 (footnote omitted).

[111]CA Final SOP at 27-28.

> The Consumer Advocate has reviewed Exhibit 3 and recommends that the Commission's Schedule A Order include a provision requiring the compilation and submission on a quarterly and timely basis of the metrics described in Exhibit 3 as a form of performance "dashboard" for each of the HECO Companies, with such information also made available concurrently on the Companies' web site(s) for review by any concerned ratepayers. Ideally, each of the Exhibit 3 statistics would be presented for a rolling eight quarters of comparable data in graphical form, showing achieved performance relative to established performance targets.[112]

Several, but not all, of the performance metrics proposed by the Consumer Advocate are included in the HECO Companies' proposed Schedule A performance metrics presented in the HECO Companies Final SOP, Exhibit 3. Regarding the performance metrics that were not included, the Consumer Advocate recommends further discussion and refinement in Schedule B.[113]

In its Initial SOP, the County of Hawaii states:

> The County believes the most relevant and important metric for customers is their "all-in" electricity costs per kWh delivered, and whether these costs have increased or decreased. The County believes customer costs should be evaluated in conjunction with the percent of renewable energy used, combined with an objective

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[112]CA Reply SOP at 20-21.

[113]CA Final SOP at 28-29.

determination of the definition of "renewable."[114]

Recognizing the commission's desire to resolve Schedule A issues expeditiously, while reserving Schedule B issues for a more in-depth discussion, the County of Hawaii suggests that "the following metrics be considered in the near-term for public discussion and potential usefulness as performance metrics":

1. Cost of final delivered energy to customer (annual average all-in cost per kWh by rate class) per Island system;
2. Overall Renewable Generation of the State and of each Island;
3. Renewable Generation provided by the Utility per Island system;
4. Cost of Utility Generation by Utility, each IPP, and by any other Source per Island system;
5. Average Transmission Losses (annual average) per Island system; and
6. Amount by which those who remain on the grid full-time subsidize those who access the grid on only a partial or emergency basis per Island system.[115]

COH states that it understands the concerns of the parties with respect to using cost as a metric, especially for management performance, "but also recognizes that many other

[114]COH Initial SOP at 4.

[115]COH Final SOP at 10.

industries are subject to changing and often highly variant input costs, yet their management is also judged (at least in part) by the price of their products."[116] The County states that "the ultimate metric for any business is the price of its products relative to their quality and other attributes important to the customer."[117] The County concludes that "not [to] include ratepayer costs as an ongoing performance metric is to ignore the metric that is likely to matter most to Hawaii's citizens and HECO customers."[118]

Blue Planet supports the approval of certain Schedule A metrics that facilitate the implementation of performance incentives in the Schedule B phase.[119] In particular, Blue Planet supports adoption of selected clean energy-related Schedule A metrics that support the HECO Companies in their ongoing efforts to advance Hawaii's clean energy future and benefit utility customers by requiring open and transparent reporting of key indices.[120] These clean energy metrics include metrics concerning fossil fuel reduction, RPS compliance, clean energy utilization, renewable energy curtailment reduction, time-of-use rates, demand response, energy storage, retirement of fossil fuel generation,

[116]COH Final SOP at 10.

[117]COH Final SOP at 10.

[118]COH Final SOP at 10.

[119]Blue Planet Final SOP at 4.

[120]Blue Planet Final SOP at 5.

reserve margin performance, and capital expenditures on renewables.[121] Except as otherwise indicated, Blue Planet states that these metrics should be reported on a consolidated, quarterly basis.[122]

Blue Planet also supports the use of certain financial metrics, such as the following: ''the utilities' rate of return, i.e., tracking the return on rate base and common equity as measured relative to rates of return authorized by the Commission; the HECO Companies' credit rating; their ratio or proportion of total equity to capitalization, and of debt to equity; and also material increases or decreases in the HECO Companies' earnings per share.''[123] However, Blue Planet defers to other parties such as the CA and the HECO Companies to develop specific methodologies for these financial metrics.[124]

In its Reply SOP, Blue Planet reiterates that it ''supports the adoption of Schedule A performance metrics that will meaningfully contribute toward the achievement of Hawaii clean energy statutory mandates and policy objectives for the benefit of utility customers.''[125] Blue Planet further observes that ''Schedule A performance metrics may possibly be incorporated into Schedule B incentives'' and that ''[t]he

[121]Blue Planet Final SOP at 5-6.

[122]Blue Planet Final SOP at 5.

[123]Blue Planet Final SOP at 7.

[124]Blue Planet Final SOP at 7.

[125]Blue Planet Reply SOP at 5.

Commission has distinguished between Schedule A performance metrics and Schedule B performance incentives, and concluded that the latter may incorporate the former.''[126]

Blue Planet also states that it does not generally object to the HECO Companies' proposals with regard to performance metrics.[127] Additionally, Blue Planet supports practices and procedures that ensure an open and transparent process that is readily accessible to utility customers and stakeholders, including posting such metrics on the HECO Companies' website.[128]

HSEA generally supports Blue Planet with respect to metrics. HSEA suggests an additional metric ''which would give an accounting of utility expenditures as they would directly benefit the installation of distributed PV.''[129] According to HSEA, this metric would be to help ''in determining to what degree the utility's grid and infrastructure improvements directly support the implementation of distributed PV, and whether or not grid upgrades and engineering solutions are

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[126]Blue Planet Reply SOP at 5.

[127]Blue Planet Reply SOP at 6. This statement is subject to two caveats. First, Blue Planet reserves the right to modify or amend its position in the remainder of this proceeding. Id. Second, to the extent that the HECO Companies' SOP may be construed to oppose or object to any of Blue Planet's proposed metrics, Blue Planet does not concur with or support the HECO SOP. Id. at 7.

[128]Blue Planet Reply SOP at 7.

[129]HSEA Final SOP at 2.

true upgrades or merely replacements and maintenance of our current system.''[130]

HREA also provides a list of suggested metrics, including metrics related to integrated resource planning, the amount of renewables installed and operating on the HECO Companies' grids, the integration of renewables, the competitive procurement of renewables, net energy metering, reliability standards, and administrative and operating and maintenance expenses.[131] However, it is unclear whether HREA is advocating the implementation of these metrics now or is suggesting that this discussion be deferred to Schedule B.[132]

In its Reply SOP, HREA further states that it supports ''further investigation of metrics described in the NRRI report in order to determine which are the most relevant to decoupling'' as well as investigation of the ''potential metrics suggested in the SOPs by Blue Planet, the County of Hawaii, the HECO Companies and HREA.''[133] HREA also provides further comments on the metrics it proposed in its Final SOP.[134]

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[130]HSEA Final SOP at 2-3.

[131]HREA Final SOP at 7-9.

[132]HREA Final SOP at 7.

[133]HREA Reply SOP at 8.

[134]HREA Reply SOP at 8-10.

B.

Issue No. 4 - Findings And Conclusions

Based on its review of the entire record and the recommendations of the parties, the commission finds and concludes as follows with respect to Issue No. 4:

1. Although the distinction is explicitly noted by several parties, there appears to remain some confusion in the parties' arguments as to the difference between the consideration of performance metrics in Schedule A and the consideration of performance incentives in Schedule B. As noted in Order No. 31635, the consideration of performance metrics in Schedule A is distinct from the performance incentives identified as an issue for consideration in Schedule B. The performance metrics considered in Schedule A are metrics to be regularly reported by the utilities without further direct linkage to financial or other incentives. While the performance incentives considered in Schedule B may ultimately incorporate these performance metrics as part of the incentive mechanisms, the performance incentives would be linked to financial or other incentives, and would not necessarily be the same as the metrics determined as reporting requirements in Schedule A.

One argument asserted by the parties with respect to Schedule A metrics is that certain metrics are not appropriate if they are not entirely representative of utility performance or if they encompass factors not entirely under the control of the utility. For example, in response to a metric proposed by COH, "Cost of final delivered energy to customer per Island system", the HECO Companies argue:

> This is not a useful metric to be provided by the Companies. Overall cost per kWh to customers is too encompassing and may not be representative of the Companies' performance. For example, differences in rates from month to month between general rate cases are largely a function of market price influences on fuel and purchased energy costs, which the Companies cannot control.[135]

The commission acknowledges that there are concerns regarding whether metrics encompassing factors beyond the control of the utility will be a factor in devising appropriate metrics for performance incentives in Schedule B. However, with respect to the metrics considered in Schedule A that are to be reported on a regular basis and made available to the general public without further direct linkage to financial or other incentives, the commission finds these concerns to be too restrictive to serve as criteria to reject an otherwise informative metric. Stated differently, a metric that provides information regarding the status of the utility or utility system that is generally relevant to considering utility performance should not be rejected as a Schedule A performance

[135]HECO Companies Reply SOP, Exhibit 1, page 1 of 12.

metric simply because it addresses only one facet of utility performance or because it encompasses factors beyond the control of the utility. As previously stated, Schedule A performance metrics are intended to provide relevant useful information, not to serve as determinants of utility incentives or penalties.

2. As discussed above, the HECO Companies offer several arguments opposing implementation of performance metrics in Schedule A, but ultimately propose a set of Schedule A performance metrics. All other parties support or do not oppose the implementation of some or all of the Schedule A performance metrics proposed by the HECO Companies.

However, the parties are not all in agreement regarding which other metrics are appropriate to implement as Schedule A performance metrics. The positions of the parties, as further explicitly clarified during oral arguments, are concisely indicated in Exhibit 1 of HECO Reply SOP and, for the HECO Companies, in Exhibit 3 of HECO Final SOP.

Each of the parties provided more detailed arguments in its own filings. Arguments regarding which metrics should be implemented as Schedule A performance metrics include, among others, whether the metrics are feasible to implement now; whether they are meaningful, useful or relevant; whether they are appropriately representative of utility performance; or whether they are otherwise inappropriate.

3. During oral argument, the parties were asked to suggest the most transparent ways to communicate any Schedule A performance metrics to the commission and the general public. (Tr. 43-44.) Suggestions included: (a) posting on the commission or utilities' websites (HECO Companies, Tr. 44); (b) posting the metrics on the HECO website and including a reference to the website in bill inserts (CA, Tr. 44); (c) providing both individual company and consolidated information as well as all relevant company reports on utility website in a logical and coherent format (Blue Planet, Tr. 44-45); (d) providing information in bill inserts, and through press conferences or composing video presentations (HREA, Tr. 45-46); and (5) maintaining individual company transparency (COH, Tr. 46-47). As noted, the HECO Companies indicated a willingness to post Schedule A performance metrics on the companies' websites; however, they were reluctant to post all currently filed reports that include related information, fearing these postings would constitute "information overload." (HECO Companies, Tr. 47-48).

4. Several parties suggested metrics that are expressed in terms of expenditures or percentages of expenditures for purposes of furthering clean energy objectives. The commission acknowledges that an identified objective in the consideration and ultimate adoption of the decoupling mechanisms

is to encourage utility pursuit of Hawaii's clean energy objectives. The commission notes, however, that it is categorically cautious concerning policies or metrics that characterize positive utility performance in terms of increased magnitude of expenditures.

5. The commission finds that it is useful and beneficial to require the HECO Companies to regularly report, maintain, and promptly periodically update the Schedule A performance metrics identified below on each of the Companies' websites.

6. In order to provide the most meaningful and transparent communication of the Schedule A metrics the commission directs the parties to participate in an iterative metrics and website development and review process as described below.

7. The HECO Companies are initially directed to develop meaningful presentations of (a) the Schedule A performance metrics as proposed by the HECO Companies in their Final SOP Exhibit 3 and (b) the metric proposed by the County of Hawaii: Cost of final delivered energy to customers by rate class for each island system. These presentations should include graphical representations where informative, historical trends where possible, and both straightforward, understandable explanations and accurate definitions in all cases.

These Schedule A performance metrics shall be posted on the HECO Company's website on a consolidated basis and, additionally, on each Company's website on an individual, company-specific basis. Financial metrics that are available only on a consolidated basis shall be presented on a consolidated basis on each Company's individual website. Links to the presentation of the consolidated Companies' metrics shall also be provided on each individual Company's website.

The HECO Companies shall, no later than April 14, 2014, develop working or "under construction" websites ("worksites") that include these Schedule A performance metrics and that are accessible to the commission and the parties for review prior to final commission approval and subsequent release to the public. The commission and the parties are to be provided with notification, including links to the worksites and a password to obtain access, when the worksites are developed and available for review. Following this notification, the parties shall provide any comments or recommendations regarding the HECO Companies' worksites to the commission within thirty (30) days of such posting.

The HECO Companies are encouraged to communicate and meet with the other parties prior to providing the initial Schedule A performance metrics and worksites. The objective of this communication between the parties and the HECO Companies is to provide constructive comment from the parties in order to improve the accuracy, transparency, meaningfulness, and effectiveness in communication of the initial Schedule A performance metrics.

8. The HECO Companies are further directed to develop the following "additional performance metrics," consistent with the above guidelines, for each utility system and on a consolidated basis:

(a) the metrics proposed by the Consumer Advocate in its Initial SOP at pages 22 and 23 that are not included in the initial Schedule A performance metrics required above;

(b) one or more metrics that together provide one or more breakdowns of the contributing cost components to customer rates;

(c) metrics that measure the amounts of storage (including breakdown of thermal, electrical or other storage), demand response measures, and subscription or utilization of time of use rates on each utility system;

(d) metrics that report the amount of renewable energy generation curtailment on each utility system; and

(e) a metric that quantifies unaccounted energy as a feasible measure of a sum of conflated transmission and distribution losses, company use, theft and metering inaccuracies.

The HECO Companies shall provide the additional performance metrics for review by the commission and parties by filing a proposal with the commission on or before April 14, 2014. The proposal shall include details regarding how the metrics will ultimately be calculated, updated, and presented on the HECO Companies' websites. The parties shall provide any comments or recommendations regarding the HECO Companies' proposal to the commission within thirty (30) days of the filing of the proposal.

The HECO Companies are encouraged to communicate and meet with the other parties prior to filing their proposal with the commission. The objective of this communication between the parties and the HECO Companies is to provide constructive comment from the parties in order to improve the accuracy, transparency, meaningfulness, and effectiveness in communication of the additional performance metrics.

9. The commission will consider the metrics regarding performance incentives to be addressed in Schedule B of this docket, which may or may not include the Schedule A metrics. The commission may, by recommendation by the parties or on its own motion, require further performance metrics to be regularly reported by the utilities to the commission and the general public.

VII.

Orders

THE COMMISSION ORDERS:

1. The commission orders the HECO Companies to utilize the short term debt rate as established in deriving the consolidated cost of capital in each company's last full rate case in computing interest on the outstanding RBA balances. The HECO Companies are directed to file amended tariffs implementing the amended interest rates identified above by March 1, 2014, to become effective by March 1, 2014.

2. The commission orders the HECO Companies to immediately investigate the possibility that they may be able to defer the payment of income taxes on the accrued amounts of decoupling revenue, and to report the results of that investigation, along with recommendations as to deferred tax treatment, to the commission and the parties within one-hundred and twenty (120) days of this Order.

3. The commission orders the HECO Companies to revise their decoupling tariffs to provide that the amount of any "Rate Base RAM - Return on Investment Adjustment" ("Rate Base RAM Adjustment") applied to the determination of Target Revenues and the RBA Rate Adjustment in accordance with the existing RAM tariffs shall include the entire effective Rate Base RAM Adjustment from the prior year, plus ninety percent of

the amount that the current RAM Period Rate Base RAM Adjustment exceeds the Rate Base RAM Adjustment from the prior year. If the prior year is a rate case test year, the amount of the Rate Base RAM applied to the determination of Target Revenues and the RBA Rate Adjustment shall be ninety percent of the RAM Period Rate Base RAM Adjustment.

The HECO Companies are directed to file amended RAM tariffs implementing the provisions identified above by March 1, 2014, and shall apply these provisions to the decoupling submittals required on or before March 31, 2014.

4. The parties are directed to address the concerns identified in this Order with respect to Schedule A Issue Nos. 2 & 3, particularly with respect to concerns regarding maintaining and enhancing the utility's incentives to control costs and appropriately allocating risk and compensation for risk, in the Schedule B proceedings.

5. The commission directs the parties to participate in an iterative metrics and website development and review process as set forth in Section VI.B. of this Order.

DONE at Honolulu, Hawaii FEB - 7 2014.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Hermina Morita
Hermina Morita, Chair

By Michael E. Champley
Michael E. Champley, Commissioner

By Lorraine H. Akiba
Lorraine H. Akiba, Commissioner

APPROVED AS TO FORM:

Thomas C. Gorak
Thomas C. Gorak
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2013-0141.sr

<u>CERTIFICATE OF SERVICE</u>

The foregoing order was served on the date of filing by mail, postage prepaid, and properly addressed to the following parties:

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